# IMPROVEMENTS TO THE WTO SUBSIDIES AND ANTIDUMPING AGREEMENTS

## PROPOSALS FOR DISCUSSION

MINISTRY OF INTERNATIONAL AND INTERGOVERNMENTAL RELATIONS

GOVERNMENT OF ALBERTA, CANADA

OCTOBER 2002

Over the past several years, Alberta producers have had to cope with countervailing duty and anti-dumping actions directed against their products. The issue of trade remedies reform is now being considered in current round of trade negotiations in the World Trade Organization (WTO).

In these negotiations, as economies are increasingly dependent on international trade, the Alberta Government wishes to ensure that the Government of Canada adopts a broad perspective that considers the relationship of trade remedies to international competitiveness and the economic changes brought about by globalization, instead of focusing exclusively on short-term, incremental, changes to meet the needs of current users of trade laws. Alberta considers this to be in the best long-term interests of producers, exporters, importers, and consumers. Alberta believes that current trade remedy systems are deeply flawed, and that one of the goals of trade policy should be to work toward the fundamental reform of anti-dumping and countervail in the context of continued market liberalization. Canada's trade policies must be focused on the future, and must give producers and consumers the tools necessary to adapt and prosper in a rapidly-changing world. This will not happen if trade rules interfere with the efforts of producers and consumers to respond to market signals and interfere with normal competitive activity.

In the Uruguay Round of multilateral trade negotiations, the Alberta Government proposed to the Government of Canada the adoption of the "net-subsidy" approach as a goal to be pursued in multilateral trade negotiations on trade laws. Under this approach, countervailing duties could only be imposed on imported products to the extent that they received subsidies greater than the subsidies received by the industry that started the trade case. The Government of Canada accepted this approach and included it in its negotiating position in the Uruguay Round. While this proposal did not receive sufficient support to have it adopted at the time, Alberta believes the proposal still has merit, and urges that it be considered again in the current WTO negotiations. In addition, every effort must be made to curtail the abuses of current systems as soon as possible, and thus Alberta has provided suggestions to this end.

In 2000, based on Alberta's experiences in agricultural trade cases, the province considered what changes could be made to make the operation of antidumping rules more fair in the agricultural sector, particularly for cyclical industries. The Alberta discussion paper, developed in consultation with the firm of Arnold & Porter of Washington, D.C., counsel for the Government of Alberta, can be found at: http://www.iir.gov.ab.ca/trade/media/ag_prod.pdf. Working again with Arnold & Porter, Alberta has developed additional proposals covering both the WTO Subsidies and Antidumping Agreements. These proposals cover a range of options from policy changes to specific changes in the application of countervailing and antidumping measures, and are also intended to stimulate discussion in this critical area.

# Memorandum

**To:** Government of Alberta

**From:** Arnold & Porter

**Date:** October 7, 2002

**Re:** **Possible Improvements to WTO Subsidies and Antidumping Agreements**

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## 1. Introduction

As the latest WTO negotiating round moves forward, Alberta officials have been examining ways to improve both the WTO Agreement on Subsidies and Countervailing Measures ("The "Subsidies Agreement") and the WTO Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (the "Antidumping Agreement"). Actions taken under both the Subsidies Agreement and the Antidumping Agreement over the past several years have posed significant risks to Alberta's trade with the United States, in particular. Accordingly, the following three sections of this memorandum outline briefly some possible reforms to these two agreements.

These proposed reforms are intended to mitigate the more egregiously unfair aspects of antidumping and countervailing duty proceedings, so that they can operate as intended, rather than creating protectionist barriers to import trade. The highly technical nature of these investigations can prevent outsiders from perceiving the important inequities created by the methodologies being applied. Indeed, effective reforms to these agreements often will involve changing details of various methodologies currently in use that can not be described in simple terms. Nonetheless, the impact of making many of these technical changes would be significant.

## 2. Possible Changes to the Agreement on Subsidies and Countervailing Measures

- The expiry of the "serious prejudice" deeming provision (SCM Article 6.1) makes it difficult to pursue remedies against trade distorting subsidies in foreign markets. Revitalizing this tool is critical, given the increasing importance of exports to the Canadian economy, and the desire of Canadian exporters to compete on a level playing field.

- The expiry of the "green-light" subsidy category (SCM Article 8.2) compromises the traffic light approach. However, if revived, these provisions need to be revised and clarified.

  - For example, it is unclear whether the regional development exemption in SCM Article 8.2(b) applied to actions taken by subnational governments, and, if it did, whether national income or employment figures had to be used.

  - In addition, the research and development support criteria to be met for "green-light" status appear to be too rigid. They risk hindering encouragement of many useful research and development activities.

  - More generally, it would have been difficult for existing programs to fit under SCM Articles 8.2(a), (b) or (c). While programs could have been designed, on a prospective basis, to fit the detailed criteria, existing programs that had a similar effect and were no more trade-distorting, would have been vulnerable to attack.

- The recent softwood lumber panel ruled that timber harvesting rights are a "financial contribution" under SCM Article 1.1(a)(1). Assuming this ruling is upheld by the WTO Appellate Body, other countries (i.e., the U.S.) would never agree to any blanket request from Canada to exempt natural resource pricing decisions from trade rules.

  However, these rules still ought to be negotiable. The application of a market pricing benchmark, for example, does not fully recognize the other values that governments might try to maximize as they manage their resources. Consideration should be given to the development of new rules that fairly address the trade distorting potential of resource management activity, while still respecting the importance of these other values.

- The recent softwood lumber panel also ruled that a pass-through analysis is needed to determine the extent to which downstream purchasers of logs or

lumber inputs benefited from any stumpage subsidies. However, the Subsidies Agreement does not set out a methodology for doing this.

- The practical application of the specificity rules in SCM Article 2.1 is unclear.

  -- It is unclear how Article 2.1(b) is qualified by Article 2.1(c), and no indication is given how the factors outlined in Article 2.1(c) are to be assessed and applied. For example, it is unclear how the "extent of diversification of economic activities" is to be taken into account.

  -- Article 2.1(c) also might need to be clarified to avoid findings of specificity in cases involving the extraction or processing of government-owned natural resources, when any limited use of the resource is not due to government action or when different industries have needs for substantially different quantities of the resource.

  -- The concepts of "predominant use " by certain enterprises and the granting of "disproportionately large" amounts of subsidy to certain enterprises also need to be clarified to ensure findings of specificity do not occur on these grounds when such enterprises receive less than 50% of the alleged subsidy being examined.

While some of these issues might be addressed in pending cases (e.g., softwood lumber), it still may be useful to consider other options for clarifying the rules.

- Consideration should be given to having the same 2% *de minimis* rate for developed and developing countries.

## 3. Possible Changes to the Antidumping Agreement

- The economic concept of "dumping" should be defined, to provide a guidepost for measuring it. Is it a price discrimination rule, a prohibition on below cost sales, or something else?

  For example, if a company produces only for export, and all its exports go to one country, should there be a basis for finding dumping if its sales are above cost? Must every single sale be above cost? The use of constructed value comparisons in such cases, with its requirement of a profit component, inherently involves the imputation of arbitrary profit rates. Why should international trading rules require any particular profit level, much less one the exporter has no way of knowing at the time it makes its sales?

- Consideration should be given to limiting the application of dumping remedies to cases where the examined producers have pricing power. In highly fragmented industries, where all participants are price takers, does it make sense to penalize producers for prices over which they have no control? This issue could be addressed using a market concentration test of the sort used in the antitrust context.

- The concept of "sales in the ordinary course of trade" (AD Article 2.2.1) needs to be clarified. In particular, whether sales below cost are made within "an extended period of time" and whether prices do not provide for the recovery of all costs "within a reasonable period of time" need to be assessed in light of the circumstances and typical commercial practice of the relevant industry.

- Consideration also should be given to eliminating or at least modifying the "below cost" test for certain industries or products. In particular, agricultural and fishery products (and not just highly perishable products) frequently must be sold below cost, due to their long production time frame and price cycles. They should be exempted from the below cost test, because frequent below cost sales are normal and necessary.

- Alternatively, raise the *de minimis* thresholds for agricultural products and other products where producers do not have market power, and price cycles can result in extended periods of sales below full cost for all participants in the industry, whether foreign or domestic.

- The allocation of costs and profits to different products produced by the same company must be done fairly, and in a manner that considers the reasons that costs are incurred and the particular factual circumstances of each case.

  - For example, in constructed value calculations, high profits enjoyed by some product lines should not be attributed to less profitable product lines.

  - One way of addressing the profit problem is to require that countries apply commercially relevant, consistent definitions of the "like product" for both price comparison and for constructed value profit purposes. For example, if price comparisons are made treating each species, grade, and dimension of lumber as a distinct like product, then in computing constructed value profit, there should be a separate profit rate computed for each such product.

    - Alternatively, rules could require that prices and costs be matched at the same level of specificity. For most agricultural products, for example, different grades of a product will be produced (and will have different

prices), but the producer will be able to compute only a single average cost. If this average cost then is compared for cost of production and constructed value purposes to the price of each individual grade, the dumping rules effectively will prohibit the exportation of lower grade products. The remedy is either to allocate costs to different products in relation to their value, or to average prices for comparison purposes at the same level of specificity that costs can be calculated.

- Consideration should be given to providing more detailed rules governing the calculation of costs of production and to explicitly excluding certain types of costs from the calculation of cost of production and constructed value.

  - Financial expenses, for example, are difficult to allocate to individual products. Equity, moreover, is not treated as a cost. Why should a company's choice of capital structure affect the prices it must charge?

  - Another category of costs that should be examined is the cost for idling or shutting down plants. One of the objectives in an AD case is to reduce the flow of imports. When duties are imposed, the foreign manufacturer may consider shutting down plants. If, however, idling and shutdown costs are counted as costs of production for the remaining merchandise produced, the unit costs are increased, thereby creating a vicious spiral that increases the dumping duties.

  - Finally, thought needs to be given to certain intangible and contingent costs, like goodwill, stock options, etc.

  For example, Canadian GAAP now has changed to prohibit the amortization of goodwill. Instead, goodwill is subject to an annual impairment test. Under current antidumping law, if a product or market deteriorates, and a company writes off some of its investment as goodwill impairment, that writeoff can be treated as a current production cost. This could greatly increase a company's cost of production, and hence its dumping margin, at the very time the market has deteriorated. There needs to be some recognition that not every expense on a company's books can or should be recovered in the pricing of a product.

- The Antidumping Agreement should be clarified to ensure that the only duties that can be imposed are those provided for, and the only adjustments that can be made are those provided for. Specifically, aim should be taken at the U.S. "anti-reimbursement regulation" under which the U.S. effectively doubles the AD or CVD duty rate unless the importer certifies that the producer or exporter did not either pay the AD or CVD duties, or reimburse the importer for such duties. This regulation has very pernicious effects, such as making it difficult

to sell a product to an unaffiliated importer using consignment or commission arrangements.

- Given the arbitrary assumptions and high degree of variance and uncertainty in anti-dumping calculations, the *de minimis* level could be raised to reduce the impact of these problems.

- While recent decisions appear to prohibit "zeroing," it would be helpful to clarify[1] Article 2.4.2 to rule out the use of this practice explicitly.[2]

- Zero or *de minimis* rates calculated for individual company respondents should be included in the calculation of the "all-others" rate applicable to other exporters.

- Dumping calculations in reviews should use the same methodologies as those used in investigations (*e.g.*, price averaging for dumping price comparisons.)

- AD Article 17.6 provides for a special standard of review for the adjudication of disputes arising out of AD investigations. The standard used by panels in other cases under the *Dispute Settlement Understanding* should apply to AD cases. The predictability of WTO dispute resolution will be undermined if there are multiple, potentially inconsistent, "permissible" interpretations of Antidumping Agreement provisions

## 4. Possible Reforms Affecting Both the Subsidies and Antidumping Agreements

- The concept of "negligible" imports should be defined in the Subsidies Agreement, and possibly redefined in the Antidumping Agreement. Even if the current 3% level in the Antidumping Agreement remains intact, the 7% "total import" rule could be eliminated. The risk of Canada being caught in a trade investigation should not be increased by the mere presence of other alleged dumping countries. Those who favour keeping the current rules might argue, for example, that commodity products are more price-sensitive, and are more likely to be harmed by so-called "negligible" levels of imports. However, when commodity products are sold into integrated continental markets (e.g., cattle), where all producers are responding to similar price signals, it is more likely that harm is being caused by other economic factors, not by dumped imports.

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[1] TN/RL/W/6

[2] Brazil, Chile and others also have advocated this clarification.

- Should countervail and anti-dumping duties only be imposed on imports to the extent that they exceed the *de minimis* level? India has suggested this for imports from developing countries in countervail cases;[3] but is there any reason why it should not apply to goods from all countries?

- The same *de minimis* rules should apply for both initial investigations and reviews.

- The "lesser duty rule" should be made mandatory when imposing countervailing and anti-dumping duties. Investigating authorities, while examining the causal link between subsidized/dumped imports and the state of the domestic industry, must not only distinguish the harm caused by the subsidies on, or dumped prices of, imports from the harm caused by other factors. They also must quantify the proportion of the harm caused by the subsidies or dumping, and require that duties be imposed only at the level necessary to offset the harm caused by these practices.

- A public interest inquiry should be mandatory in all CVD and AD investigations and all reviews to ensure that enforcement of trade rules does not penalize consumers and purchasers of inputs, while doing little to encourage the development of competitive markets. In the U.S., for example, there is no mechanism to reduce or eliminate duties even when the costs of trade action to consumers/input purchasers outweigh the benefits to petitioning producers (e.g., softwood lumber, steel).

  This concept may be difficult to implement, and any decision to modify (or not, as the case may be) the relief available to petitioners will be controversial. It is also unclear whether stringent WTO review of this type of requirement is feasible. (That is, aside from requiring domestic authorities to weigh the economic costs and benefits of imposing duties at a given level, how can the WTO evaluate the fairness of the domestic assessment, when it involves balancing quintessentially domestic political issues?) However, expanding the power of multiple stakeholders to affect the outcome of trade proceedings may exert some discipline over the development and application of domestic trade laws.

- Product under investigation/"like product": Rules should be clarified so that specific products are not lumped together and treated as the same like product if they, in fact, compete in different market segments. These distinctions would be respected consistently when determining standing and injury, as well as when evaluating subsidies or dumping.

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[3] TN/RL/W/4

- Standing/definition of "domestic industry": While a petition requires the support of producers representing over 50% of total domestic production that expresses a view, a case can go ahead when only 25% of the domestic industry is in favour. Perhaps this two-part test should be turned into a simple requirement that at least 50% of the domestic industry needs to support the petition. This would lessen the risk of trade cases being launched at the behest of small, but well-organized lobbies that do not represent the interests of the majority of the industry.

- There also needs to be clarification of how the views of employees are supposed to be taken into account when the level of industry support is being considered, particularly when the views of management might differ.

- Similarly, it will be important to clarify who qualifies as a worker in the industry. The status of unemployed workers, ancillary unions, and wholesalers in determining industry support for a petition remains unclear.

- More specialized rules may be needed to determine standing when firms are represented by industry associations or workers are represented by unions. For example, is it appropriate for all the members of an industry association to be considered to support a petition when only a bare majority of members is in favour of initiating a case? Perhaps industry support information from associations should be accepted only if there is verifiable data regarding the members of the association (identity, volume of production, whether they voted, and how they voted, etc.). Further, the votes would be counted individually and only once for each producer. This would solve the problem of overlapping association membership leading to doublecounting supposed support. While this might disadvantage less-organized associations, it would help prevent the initiation of cases where support cannot be shown to exist.

- Alternatively, a provision could be added requiring that industry support be demonstrated by actual producers only, not by surrogates like trade associations.

- It also needs to be considered what impact these potential new rules for determining standing might have on determining the levels of exporting industry "support" for anti-dumping undertakings.

- Given the length, complexity, and cost of trade investigations, consideration should be given to an expedited dispute resolution process to ensure that there has been compliance with rules dealing with the initiation of trade cases (e.g.,

standing, product definition, evidence of subsidy/dumping, injury, causation, etc.)

- A requirement should be added that injury be assessed within the context of the business cycle of the industry examined. Certain industries are highly cyclical; the downturn in the cycle should not be regarded as injury warranting trade relief.